Wind Farm Contracting and Financing: Negotiating Financeable Project Documents for Maximum Profit in Today's Economy

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In this time of ongoing technical, economic, and political change, investors and lenders continue to take a cautious approach to determining whether to provide financing for a U.S. wind project. One key to the profitable development of wind projects is the efficient negotiation of financeable project documents. Industry-standard approaches to key contract provisions can increase the efficiency in the project document negotiation process. Additional attention during negotiation and documentation up front can lead to a more efficient and economical financing process. This article highlights some suggestions for contracting approaches to enable the U.S. wind industry to better take advantage of available financing sources.

Close Gaps & Harmonize Overlaps

Power projects in traditional energy industries are often delivered by a single lump-sum turnkey "EPC" contractor that handles all engineering, procurement, and construction for the project. From a financing party's perspective, this model is attractive because there is one point of responsibility under one contract for all of the risks involved in building a complex power project. In the wind industry, by contrast, projects are often constructed by owners and developers pursuant to multiple contracts with various parties, including turbine suppliers, engineers, consultants, one or more balance-of-plant contractors, transporters, and utilities. Each of these contractors has its own contract, and the nature of the project development often results in these contracts being negotiated at different times. As a result, there can be gaps and overlaps at the interface points among these contracts, leaving holes in the responsibility framework that by default become the responsibility of the owner. Lenders must assess these risks, and will often be uncomfortable if the owner is taking on risks that are more appropriately or efficiently borne by other parties to the contracts.

In order to get lenders comfortable that risks have been identified and allocated appropriately, the overall project document structure should, to the extent possible, eliminate gaps, overlaps, and inconsistencies among the responsibilities of contractors and

consultants developing the project. Overlaps and inconsistencies often arise when one aspect of the project is to be handed off from one contractor to another. Particularly frequent trouble spots include interface points between contractors relating to:

- turbine delivery;
- unloading and transportation of equipment within the site;
- mechanical completion walkdowns and commissioning;
- project schedule;
- warranties;
- site safety and security; and
- environmental issues and hazardous materials.

Lenders are keen to mitigate these risks because they can lead to disputes and change orders that can bust a budget. Lenders know that owners may require unbudgeted money or time to resolve such an issue, which may involve bringing in additional technical expertise or an additional contractor. It is easy to lose sight of the big picture when negotiating individual contracts and to forget how critical it is that each contract align carefully with the other contracts that relate to the work. If contract parties and their counsel can anticipate, negotiate and carefully document the various responsibilities, this can mitigate the risk of change orders and give lenders comfort as they analyze the financial model underpinning the financing. Proactively assessing and minimizing gaps prior to financing will make the project more attractive and make the financing process more efficient.

Make Known the Unknown

Project contracts often contain many ambiguities in areas that govern unpredictable events that may impact projects. Parties often negotiating individual project contracts in a relative vacuum or with imperfect information about how exactly the project will progress. This can result in ambiguous or vague provisions that can be legitimately interpreted a variety of ways by owners and contractors. These provisions are “red flags” for lenders and their counsel, as they scrutinize the aspects of contracts that can lead to disputes during risk assessment and diligence. Once again, financing parties can be concerned that ambiguous provisions will be a breeding ground for contractor claims for cost and/or schedule adjustments, affecting the financeability assumptions.

- One example of a provision that is often ambiguous is a description of the circumstances under which a contractor can claim a force majeure or excusable event. Often the descriptions of various weather events are the worst offenders, such as “extreme weather”, “unusual weather”, “excessive rainfall or snowfall”, or “weather restrictions on roadways.” Lenders are uncomfortable with these vague phrases because they weaken their confidence in the anticipated construction budget and schedule. While it is impossible to predict weather, it is possible to provide more clarity in these provisions based on the specifics of the project site and the anticipated construction season(s). The parties should analyze the typical weather patterns at the project site at the relevant time of year and decide who will bear the cost and schedule risk for particular deviations. Six inches of snow in the winter or one and a half inches of spring rain in a 24-hour period may be uncommon in certain parts of the United States, but many project sites in the northern plains regularly see such amounts multiple times per year. Often there are detailed local weather averages and other data (e.g., the closest airport or National Oceanic and Atmospheric Administration weather site) that can be used as a benchmark to provide clarity to such provisions and clearly allocate risks associated with very specific types of weather conditions. It may be difficult to know with certainly the impact that “frost laws” restricting heavy travel on country roads will have on your project, but it is helpful to be aware of them and factor them into the schedule and force majeure provisions. Aside from the question of whether it is more appropriate for owners or contractors to bear the risk of such events, lenders will have much more confidence in a project schedule and budget that accounts for site-specific weather patterns than one that does not and ends up being unrealistically optimistic.
- Another area for ambiguity that can benefit from clarity in a contract is a provision detailing how cost adjustments will actually be calculated. Ambiguities in how much a change order may cost

can be addressed by including narrowly tailored allowance provisions, unit pricing schedules, material rate sheets and labor rate sheets.

- In addition, because there can be multiple contractors working on the project, undefined costs can arise if one contractor delays the ability of another contractor to perform its work. It is often unclear, for example, whether an owner will be able to efficiently recover from one tardy contractor a sufficient amount to compensate other impacted contractors and the owner itself for any damages resulting from such delay. To the maximum extent possible, liquidated damages should be identified and carefully valued at these key interface points to ensure that an owner doesn't have exposure for delays caused by contractors.

A key tenet of financing party risk assessment is whether the risk of increased costs or schedule delays is appropriately placed with the party best positioned to mitigate such risk. Being realistic about unknowns that can affect the project is helpful for all parties involved. By avoiding addressing risks with ambiguous contract language, there is yet another potential avenue for overall cost and schedule delays that impact the attractiveness of a project for financing.

Tailor Warranties

Just as ambiguous provisions can benefit from greater clarity, contractor warranties can often benefit from greater specificity. Due to the nature of project document negotiation, the starting point for contracts is often a variation of the contractor's standard forms and those forms include the contractor's standard warranty. Contractors are understandably hesitant to modify much of their warranty—usually on the theory that it is an integral part of the product or service that the owner has agreed to buy. However, many standard warranties are written on a general basis and can and should be modified to account for project specifics where appropriate.

- One example relates to warranties that are individualized to a small subset of the project, such as per-turbine defect warranties. In projects with a compressed and rapid construction schedule, per-turbine warranties may not concern lenders. If, however, construction is likely to be extended or divided into phases, multiple warranty start and end dates can create logistical mismatches with both the anticipated financial model and operating budgets as well as any corresponding service contracts (for which warranty end-dates are often a key trigger point). In addition, the longer a defect warranty begins to run before the commercial start date of the project, the less attractive it will make the project to financing parties. This is particularly true if the turbine is new and unproven or has a history of technical problems. As a result, depending on the specifics of a project and its financing plan, harmonizing or otherwise modifying these types of warranty provisions can help make a project more attractive for financing.
- As with individualized warranties, warranty conditions and exclusions can benefit from being tailored to the specifics of a project. It is common, for example, to see a warranty exclusion stating that a turbine warranty is not valid to the extent the turbines are not operated and maintained in accordance with the turbine supplier's manuals. It is also common, however, for the same turbine supplier to be the party providing operations and maintenance at the project. Read literally, the turbine supplier's actions under one contract could vitiate the owner's warranty under another. This inconsistency is usually simply the result of the turbine supply and service contract forms being developed on a stand-alone basis. It is, however, an inconsistency that will be flagged by financing parties during their diligence review as a risk that is improperly placed on the owner.

If nothing else, the US wind industry can be characterized as rapidly-changing. The same holds true for what financing parties consider "market" for warranty terms and provisions. Contractors will be more marketable if they are willing to regularly revisit their form warranty provisions in light of rapidly-changing market standards. Owners should similarly be aware that out-of-market warranties will be scrutinized by financing parties regardless of whether they were previously approved by the owner.

Clear Title

As noted above, the development of a wind energy project can take place over many years. Often, depending on the market, certain project contracts are executed a number of years before commercial operation. For example, real estate leases, permits, easements and roads agreements are often executed at the outset of project development. The same is true of contracts relating to the purchase of certain long-lead time equipment, such as transformers, or the supply of turbines via a "framework", "reservation" or "master" agreement. It is not uncommon for these agreements to be executed in the name of the developer itself (or one of its subsidiaries) or, alternatively bought by or assigned to the developer from another entity entirely.

At the financing stage, it is often the case that a special purpose project company is the full legal owner of the project and all rights and obligations under the project documents. As a result, financing parties will often ask to review documentation (including any purchase, assignment, merger, amendment, or other documents) demonstrating the ownership structure. Financing is handled more efficiently in circumstances when Owners and their counsel have been proactive about securing and assembling formal documentation from its counter-parties demonstrating that the ownership structure is properly reflected in all project documents. This "real estate cleanup" or "assignment acknowledgments" can sometimes take a backseat, but should not be forgotten. These tasks will be required by most financing parties as a condition to closing and can often take some time to complete.

Don't Forget the "Boilerplate"

Finally, some provisions that seem like legal boilerplate draw extra scrutiny from financing parties. Not surprisingly, the lenders are very interested in provisions establishing financing party rights and obligations. Most owners and contractors are aware of, and include, financing party rights to collateral assignment. However, financing parties often also expect a number of other rights such as:

- being named as additional insureds under insurance policies;
- being indemnified pursuant to indemnification provisions;
- having rights to take assignment of licenses;
- sharing of confidential information;
- ongoing cooperation; and
- involvement and approval (often through an independent engineer) in various stages of testing and completion.

The failure to include these provisions, or the inclusion of obligations or restrictions on financing party actions (such as subsequent sales of the project), will often delay the diligence and financing process. While true that many of these shortcomings can be dealt during the negotiation of a separate lender consent, they can take time to resolve and can considerably slow the effort to reach financial close. A key part of making project documents financeable is to anticipate and include standard financing party provisions in all project documents. Many form contracts are missing these provisions, so some diligence in drafting these provisions early on will save time and money later.

Making Project Documents Financeable

In the current financing environment, unfavorable, out-of-market, or poorly drafted provisions in key project documents can be stumbling blocks to favorable and timely financing of wind farms. The result can be significant delay and additional cost in the financing process as finance parties, attorneys, owners, and contractors have to renegotiate project agreements. Anticipating and proactively taking industry-standard approaches with respect to gaps, ambiguities, warranties, ownership and financing party boilerplate can streamline the financing process and make projects more attractive to debt and equity alike.

Author Bios

Joanna Horsnail is a partner in Mayer Brown's Government and Global Projects Practice Groups. Joanna advises on design, construction, supply, warranty, operations and maintenance, and other related agreements for complex project development and financing matters, and has specific and deep expertise in the renewable energy sector. Joanna has represented several large developers/owners in the

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Nate Galer is a senior associate in Mayer Brown's Global Projects and Renewable Energy Groups. Nate has extensive experience representing lenders, owners, developers and suppliers in the review and preparation of a wide variety of wind farm documentation. He has advised on financing and security documentation, joint development agreements, consulting services agreements, engineering and professional services agreements, wind turbine supply and framework agreements, warranty agreements, construction and installation agreements, balance of plant agreements and operation and maintenance agreements. ◆

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